SUPREME COURT, U.S.
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No. 95-790

In The

# Supreme Court of the United States

October Term, 1995

SOUTHMARK CORPORATION,

*Petitioner,*

*vs.*

D. VINSON MARLEY,

*Respondent.*

*On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit*

## RESPONDENT'S BRIEF IN OPPOSITION

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## QUESTIONS PRESENTED

Whether this Court should grant certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") that for purposes of Petitioner Southmark Corporation's cause of action under 11 U.S.C. § 547(b), the transfer to Respondent was not made on account of an antecedent debt?

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I

## OPINIONS BELOW

On July 15, 1993, the United States Bankruptcy Court for the Northern District of Texas, Dallas Division (the "Bankruptcy Court"), entered its Judgment denying the claim of Petitioner Southmark Corporation ("Southmark") that $400,000 paid to Respondent D. Vinson Marley ("Marley") was a preferential transfer under 11 U.S.C. § 547(b) (or a fraudulent conveyance under § 548) due to, among other reasons, (i) Southmark did not have an interest in the property transferred to Marley, and (ii) the transfer to Marley was not on account of an antecedent debt. *See* Southmark Corporation's Petition for Writ of Certiorari (hereinafter referred to as "the Petition"), App. 25-28. Southmark subsequently appealed the decision of the Bankruptcy Court.

On July 25, 1994, the United States District Court for the Northern District of Texas (the "District Court"), entered its Memorandum Order and Judgment affirming the decision of the Bankruptcy Court that the transfer to Marley was not a preferential transfer under 11 U.S.C. § 547(b). Southmark then appealed the decision of the District Court.

On June 26, 1995, the Fifth Circuit, after oral argument, affirmed the decisions of the District Court and the Bankruptcy Court. *See Southmark Corporation v. Marley (In the Matter of Southmark Corporation)*, 55 F.3d 1071 (5th Cir. 1995). Consequently, Southmark petitioned for rehearing. The Fifth Circuit denied Southmark's petition for rehearing on August 8, 1995. Although the Fifth Circuit vacated its original opinion, it reaffirmed the decisions of the District Court and the Bankruptcy Court in its subsequent opinion. *See Southmark Corporation v. Marley (In re Southmark Corporation)*, 62 F.3d 104 (5th Cir. 1995). Southmark's second petition for rehearing was denied on August 30, 1995. Southmark has therefore petitioned this Court for a writ of certiorari.

Respondent Marley respectfully requests that this Court deny Southmark's petition for writ of certiorari because the purported conflict of the Fifth Circuit's decision with other circuits is illusory in that the decisions can be reconciled. Further, the prior decisions rendered in this case are predicated upon the analysis of complex fact situations. It is the purported erroneous interpretation of these facts which, in essence, is the nexus for Southmark's allegations.

## STATEMENT OF THE CASE

On August 16, 1982, Southmark and Marley executed an Employment Agreement (the "Employment Agreement"). Pursuant to paragraph 10 of the Employment Agreement, Marley was entitled to certain benefits upon his termination from Southmark and all its related entities.

Subsequent to the execution of the Employment Agreement between Southmark and Marley, Southmark transferred its employees to Southmark of Texas, Inc. in order to minimize franchise and social security taxes. By merger with other Southmark subsidiaries, Southmark of Texas, Inc. became the entity known as North American Mortgage Investors, Inc. ("NAMI"). Since at least 1988, the 941 quarterly tax reports filed with the Internal Revenue Service reflect NAMI as the employing entity for the corporate employees (including Marley). In addition, the bankruptcy schedules and statement of financial affairs filed with the Bankruptcy Court reflect that Southmark had no employees. *See* Petition, App. 26. Southmark continued to use the services of Marley under an employee leasing-type system with NAMI. The 1099 statement for 1989 and the W-2 statements of Marley for the years 1987, 1988 and 1989 reflect that Marley was an employee of NAMI.

Southmark had an agreement with all its subsidiaries for

Southmark to act as a central clearing house for the management of cash for the benefit of Southmark's subsidiaries. The officers of the various subsidiaries were also officers of Southmark. *See* Petition, App. 23-24. Since 1988, various Southmark entities, including NAMI, in the regular course of business, upstreamed monies into Account No. 538001448 (the "Concentration Account") at San Jacinto Savings Association ("San Jacinto") under the conglomerate cash management system. (This cash management system was, with the consent of Southmark, directed by the Bankruptcy Court to be continued post-petition. *See* Petition, App. 24.)

On Friday, April 28, 1989, Arthur G. Weiss and Marley executed a Letter Agreement (the Letter Agreement"). The Letter Agreement provided that Marley would receive $400,000 in consideration of: (i) Marley relinquishing any and all rights that he may have had under the Employment Agreement; and (ii) Marley acting as a consultant from April 30, 1989 through July 31, 1989.

On or about April 28, 1989, Larry Searles ("Searles"), the payroll coordinator for Southmark and its subsidiaries, was directed by his supervisor to prepare for Marley his last paycheck in the amount of $400,000. This last paycheck was issued as Check No.1734 for Account No. 538002909 (the "Payroll Account"), which account was styled "Southmark Corporate Payroll" at San Jacinto. All of the deposits into the Payroll Account came from the Concentration Account. *See* Petition, App. 23. Check No. 1734 was delivered to Marley on April 28, 1989, the same date Marley executed the Letter Agreement.

On Thursday, April 27, 1989, one day before Check No. 1734 was delivered to Marley, the Payroll Account had a balance of $13,423.78. On April 27, 1989, NAMI transferred $475,000 into the Concentration Account. After NAMI wire-transferred the

$475,000 to the Concentration Account, the Concentration Account had a balance of $604,525.80 on April 27, 1989.

The amount needed for the regular payroll due on Friday, April 28, 1989 was $657,683; accordingly, on April 28, 1989, a transfer of $657,683 was made into the Payroll Account from the Concentration Account. The express purpose of this transfer was to fund the payroll due on April 28, 1989.

Check No. 1734 was written on Friday, April 28, 1989, and issued to Marley. Since the Payroll Account only had $13,423.78 prior to the $657,683 transfer from the Concentration Account, and the $657,683 transfer was specifically transferred to cover the regular payroll (exclusive of the Marley transfer), the Payroll Account had insufficient funds to cover Check No. 1734. In order to fund Check No. 1734, therefore, Searles requested a transfer in the amount of $425,000 from the Concentration Account on April 28, 1989. This transfer request was made later than the normal payroll deposit to specifically cover Check No. 1734. However, after the transfer of funds from the Concentration Account to the Payroll Account to cover the regular payroll, the Concentration Account had a balance of only $206.81 on Friday, April 28, 1989, an insufficient amount to comply with the requested $425,000 transfer.

On Monday, May 1, 1989, the Concentration Account received sufficient deposits from the Southmark subsidiaries to comply with the requested transfer of $425,000 into the Payroll Account to fund Check No. 1734. After this transfer, the balance in the Payroll Account, was, as of Monday, May 1, 1989, $723,869.37. Check No. 1734 was honored by San Jacinto on May 4, 1989.

Southmark filed its voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Code") on

July 14, 1989 in the United States Bankruptcy Court for the Northern District of Georgia, Atlanta Division. On October 3, 1989, venue was transferred to Dallas. Southmark initiated its adversary proceeding on June 19, 1991 by filing its Complaint for Avoidance and Recovery of Preferential and Fraudulent Transfer. On July 11, 1991, Southmark filed its First Amended Complaint for Avoidance and Recovery of Preferential and Fraudulent Transfer and Turnover.

## REASONS FOR DENYING THE WRIT

### I.

### THERE IS NO CONFLICT BETWEEN THE FIFTH CIRCUIT'S DECISION AND THE DECISIONS OF THE EIGHTH CIRCUIT, THE FOURTH CIRCUIT AND THE NINTH CIRCUIT.

The Fifth Circuit properly determined that, under the terms of the Employment Agreement, and for purposes of Southmark's cause of action under § 547(b) of the Code, Southmark incurred its debt to Marley at the time it executed the Letter Agreement. Southmark asserts that this decision is in direct conflict with decisions in the United States Court of Appeals for the Eighth Circuit, the United States Court of Appeals for the Fourth Circuit and the United States Court of Appeals for the Ninth Circuit. The cases cited by Petitioner deal with fact situations inapplicable to the present case. It is therefore not surprising that, upon a cursory review, the holdings in these cases could be viewed as contrary to the Fifth Circuit's decision. A careful analysis of the cases cited by Southmark as indicative of the circuit conflict, however, illustrates that the decision of the Fifth Circuit is in accord with the decisions of the other circuits.

In *United States of America acting through the Agricultural Stabilization and Conservation Service v. Gerth*, 991 F.2d 1428

(8th Cir. 1993), the United States Court of Appeals for the Eighth Circuit (the "Eighth Circuit") addressed the issue of whether the assumption of executory Conservation Reserve Program ("CRP") contracts by a debtor-in-possession under 11 U.S.C. § 553 (the Bankruptcy Code section dealing with a creditor's right to set off mutual obligations between the creditor and the debtor) transformed the payment obligations of the Department of Agriculture into postpetition obligations. *Gerth*, 991 F.2d at 1429-1430. The Eighth Circuit followed the reasoning of *Moratzka v. United States of America; Agricultural Stabilization and Conservation Service (In re Mathieson)*, 63 B.R. 56 (D. Minn. 1986) and held that the mere assumption of the executory CRP contracts did "not alter when the obligations under the contract arose." *Gerth*, 991 F.2d at 1432. Rather, it was the contract at issue which determined whether the claims arose prepetition or postpetition. *Gerth*, 991 F.2d at 1432, 1433. Consequently, it was necessary to examine the contract at issue to determine the prepetition or postpetition nature of the claim. *Gerth*, 991 F.2d at 1432.

Although the Fifth Circuit in *Southmark* addressed a cause of action under 11 U.S.C. § 547(b), the Court similarly reasoned that the terms of the Employment Agreement (*i.e.*, the contract at issue), were dispositive of whether the debt due to Marley was incurred at the time of the execution of the Employment Agreement or upon Marley's termination. The analytical basis for the Eighth Circuit's decision in *Gerth* and the Fifth Circuit's decision in *Southmark* is the examination of the contract at issue. Accordingly, there is no conflict between the Eighth Circuit and the Fifth Circuit. (Indeed, one of the judges who rendered the Fifth Circuit's decision is a Circuit Judge of the Eighth Circuit who happened to be sitting by designation.)

Southmark cites *Stewart Foods, Inc. v. Broecker (In re Stewart Foods, Inc.)*, 64 F.3d 141 (4th Cir. 1995) as indicative of

the purported conflict between the Fifth Circuit and the United States Court of Appeals for the Fourth Circuit (the "Fourth Circuit") with respect to the date a debt arises under an executory contract. In *Stewart Foods*, however, the Fourth Circuit addressed the issue of whether "a debtor's obligation to pay money under a *nonexecutory* [emphasis added] contract remains a continuing obligation on the debtor after the bankruptcy filing, or simply gives the creditor a claim against the bankruptcy estate." *Stewart Foods*, 64 F.3d at 143. The Fourth Circuit concluded that the nonexecutory contract afforded the creditor a claim against the debtor's estate. This decision was based upon an examination of the contract at issue. *See Stewart Foods*, 64 F.3d at 146. Accordingly, there is no conflict between the Fourth Circuit and the Fifth Circuit.

Finally, Southmark cites *In re Upstairs Gallery*, 167 B.R. 915 (9th Cir. BAP 1994) as evidence of the conflict between the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit") and the Fifth Circuit's decision in *Southmark*. In *Upstairs Gallery* the Ninth Circuit addressed the issue of whether a debtor/tenant's payment of certain funds to the landlord in settlement of the tenant's lease obligations constituted a transfer for or on account of antecedent debt. *Upstairs Gallery*, 167 B.R. at 917. The Ninth Circuit concluded that the transfer by the debtor/tenant in settlement of its lease obligations was on account of an antecedent debt.

The court's reasoning was based upon (i) the determination of whether a debt is antecedent or current depends on when the debt was incurred, and (ii) the debt is incurred when the debtor becomes legally obligated to pay. *Upstairs Gallery*, 167 B.R. at 918. The Ninth Circuit noted with approval the reasoning of the court in *In re Pan Trading Corp.*, 125 B.R. 869 (Bankr. S.D.N.Y. 1991).

> The *Pan Trading* court reasoned that lease payment obligations arise when they become due and payable because of the contemporaneous manner in which money and services are exchanged and the facile divisibility of the separate rent payments. As a rule, payments apply specifically to the period in which they are paid.

*Upstairs Gallery*, 167 B.R. at 918 (cite omitted). The Ninth Circuit, however, reasoned that payment obligations under a lease arise when due based upon the concurrent possession of the leased premises by the tenant. *See Upstairs Gallery*, 167 B.R. at 918. The court therefore distinguished *Upstairs Gallery* on the basis that the transfer was not consideration for concurrent possession, but rather the debtor/tenant relinquished its rights to future possession along with the transfer. *Upstairs Gallery*, 167 B.R. at 918.

After distinguishing *Upstairs Gallery*, the Ninth Circuit determined that the debt was incurred at the time the lease agreement was executed. The court reasoned that "[a] contract which is unambiguous in its terms on which the parties have agreed governs the relationship between the parties. (cite omitted)" *Upstairs Gallery*, 167 B.R. at 918. Clearly, therefore, the Ninth Circuit arrived at its decision based upon an examination of the contract at issue. This was the same examination performed by the Fifth Circuit in *Southmark*.

In determining that the debt due Marley was incurred upon his termination, the Fifth Circuit employed the same basic principles of contract interpretation set forth in the Restatement of Contracts; i.e. the promisor's conditional obligation to pay did not arise until the applicable condition (which condition was solely within the promisor's discretion) occurred. *See*

*Restatement (Second) of Contracts* § 77; *In re Bank of New England Corporation*, 187 B.R. 405 (Bankr. E.D. Mass. 1995); *In re Intercontinental Publications*, 131 B.R. 544 (Bankr. D. Conn. 1991). *See also*, Petition, App. 28. The Petitioner appears to base its contention of a circuit conflict upon the unfavorable result (from the Petitioner's perspective) reached by the Fifth Circuit rather than upon the process of legal review employed by the Fifth Circuit, the Eighth Circuit, the Fourth Circuit and the Ninth Circuit. An analysis of the circuit decisions, however, reveals that any perceived conflict is merely illusory.

## II.

## THERE IS NO CONFLICT BETWEEN THE FIFTH CIRCUIT'S DECISION AND *BARNHILL*.

In *Barnhill v. Johnson*, 503 U.S. 393, 112 S. Ct. 1386, 118 L. Ed. 2d 39, this Court determined "whether, under the definition of transfer provided by § 101(54), and supplemented by § 547(e)," a bankruptcy trustee could avoid a transfer made by check as a preferential transfer. *Barnhill*, 112 S. Ct. at 1389. Based upon those guidelines, this Court held that, for purposes of determining if a transfer occurred within the 90-day preference period, a transfer made by check should be deemed to occur on the date the drawee bank honors it. *Barnhill*, 112 S. Ct. at 1388. Petitioner Southmark asserts that, in its *Southmark* opinion, "the Fifth Circuit held that the transfer date for purposes of 11 U.S.C. § 547(b)(2) would be the date the check was delivered rather than honored." *Petition*, p. 12. Actually, the Fifth Circuit held that, for purposes of determining whether the transfer made by check was a preferential transfer, "the transfer [to Marley] occurred at the time of honor." *Southmark*, 62 F.3d at 107. Consequently, there is no conflict between the Fifth Circuit's decision and Barnhill.

## III.

## THE FIFTH CIRCUIT'S DECISION ACHIEVES THE PURPOSE OF 11 U.S.C. § 547(b).

Petitioner Southmark states that "[a] proper evaluation of all of 11 U.S.C. § 547 reveals that payment by check is a preferential transfer." Petition, p. 14. Presumably, Southmark intended to state that a court could determine that a payment by check is a preferential transfer provided that the debtor has satisfied its burden of proof under 11 U.S.C. § 547. Previously, it has been the task of the lower courts to examine the credibility of Marley (and the incredibility of Southmark's witnesses) and sift through the complex fact situations presented by this case in order to differentiate between what Southmark states and the proven facts. Indeed, to paraphrase Samuel Butler, it is not the lying that is troublesome, it is the inaccuracy. The conclusions culled from these proven facts are not only legally correct but are also in accord with the purpose of 11 U.S.C. § 547(b).

Under 11 U.S.C. § 547(b), "the trustee may avoid any transfer of *an interest of the debtor in property* . . ." as a preference. The Bankruptcy Court concluded, after hearing considerable evidence, that Southmark failed to meet its burden of proof that Southmark had an interest in the property transferred. On appeal, the District Court correctly reasoned that the threshold and dispositive inquiry on appeal was whether the Bankruptcy Court erred in determining that Southmark had no interest in the property transferred to Marley. In its Memorandum and Order, not only did the District Court determine that the Bankruptcy Court's decision concerning Southmark's interest was not clearly erroneous, but it also could not state whether "the bankruptcy court was in error at all." Petition, App. 14-15. The District Court was similarly not persuaded that the Bankruptcy Court erred in concluding that the transfer to Marley was not on account of an antecedent debt. Petition, App. 16.

In its *Southmark* decision, the Fifth Circuit did not address the issue of whether Southmark had an interest in the property transferred to Marley but instead addressed the issue of whether the transfer was made on account of an antecedent debt. *Southmark*, 62 F.3d at 105. Although the instant appeal is based upon the Fifth Circuit's conclusion that the transfer was not on account of an antecedent debt, it is worth noting that, despite Southmark's argument for reversing the District Court on the grounds that Southmark had an interest in the property transferred, the Fifth Circuit did not do so.

In *Southmark*, the Fifth Circuit applied the correct legal standards for review and reached the same conclusions as the Bankruptcy Court and the District Court, namely that the transfer to Marley was not a preferential transfer under 11 U.S.C. § 547(b). Through the various stages of appeal, the courts have consistently recognized the deference required to the trier of fact in applying the correct legal conclusions to be drawn from the proven facts of this case. Regardless of whether the lower court decisions were primarily based upon the lack of any interest of Southmark in the property transferred to Marley or that the transfer was not on account of an antecedent debt, the determination that the transfer to Marley was not a preferential transfer of an interest of Southmark under 11 U.S.C. § 547(b) was the correct result.

## CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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